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No. 9946

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

FRANK BOGART,

Appellant,

vs.

MILLER LAND AND LIVESTOCK COMPANY,

Appellee.

BRIEF FOR APPELLEE.

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STATEMENT OF THE CASE.

The Appellant's statement of the case fails to mention facts which Appellee deems essential to a consideration of the issues involved on this appeal. Appellee therefore respectfully presents its own statement of the case.

The Appellee, Miller Land and Livestock Company, is the same corporation as the E. L. Dana Livestock Company, there having been a change of corporate name. These names are sprinkled throughout the record and some confusion might result unless this be known. While Appellee deems it immaterial, it no place appears in the record that Appellee "acquired the property subject to the mortgage without any assumption or agreement to pay the mortgage debt", as stated in the first paragraph of Appellant's statement

of the case. It does appear that the claim that Frank Bogart filed is merely a claim against the property of the debtor. (R. p. 13.) It also appears that Mr. Bogart released E. L. Dana and Fra Dana from personal liability upon the promissory notes mentioned in said claim, and that, "There has been filed by the said Bogart proper and sufficient release of the mortgage of the E. L. Dana Livestock Company recorded", etc. (R. p. 14.)

If Appellant has a claim only against the property of the Appellee it appears to be by his own act of choosing to be in that position.

The Appellant did not deny the truth of Appellee's petition for a reduction in the interest rate but contented himself with contending that the Court had no jurisdiction to grant such reduction and that the petition did not state facts sufficient to warrant the granting of such relief. (R. p. 73.)

The petition requesting such relief was a cross petition to a petition by Appellant for permission to foreclose his mortgage. (R. pp. 61-66.)

The order appealed from was the result of the last series of proceedings involving the correct interpretation of certain terms of the order of March 8, 1940, confirming the proposal and providing how it should be carried out. This order is not in the record but the parties by stipulation have agreed that the Court may consider it, if it is believed to be material by the Court.

From the uncontradicted petition asking for the reduction of the interest rate, it appears that "Frank

Bogart is not acting in good faith toward petitioner and its other creditors in that his action demonstates that he would rather have the security than the money due him". That by so doing he would make a large, unearned and unjust profit at the expense of the Debtor and its unsecured creditors. That in an effort to bring about such a result he has maintained a series of vexatious, harassing and unfounded objections, petitions, motions, and other proceedings, etc. (R. p. 68. Par. VI.)

That on the mortgage involved Appellant Bogart has already received $220,000 in interest and a bonus of $20,000 for a verbal promise to extend the mortgage and reduce the interest from 8% to 6%. (R. p. 69.)

That the Debtor in order to increase the productivity of the property and to more quickly pay off its creditors has made, since the commencement of this proceeding, extensive and valuable improvements of the security which was worth greatly in excess of the mortgage at the commencement of the proceeding. (R. p. 68.)

That considering the value of the security, the amount of the investment, the present money market and all the circumstances surrounding such investment as well as the best interests of all the parties, including unsecured creditors who have claims of approximately $200,000, it is just, equitable and right that the Court should reduce the interest rate, etc. and "that the proposal heretofore made be modified accordingly, insofar as the claim of Frank Bogart is concerned". (R. p. 69. Par VIII.)

That by presently conserving the assets of the Debtor by a reduction of the interest rate it will lessen the time within which all creditors shall be paid. (R. p. 70.) That the security is worth $800,000 and the claim (then) was approximately $180,000. Since then $17,877.50 has been paid and other payments are pending. (R. p. 63-64.)

The Court below heard the statements of Counsel, called for briefs and being convinced that the Court had authority to entertain the request and that a proper case had been presented reduced the rate from 6% to 4%.

The petition asked for a reduction of interest rate not only as to future payments but to interest since the proceedings were commenced April 13, 1938.

ARGUMENT AND AUTHORITIES.

THIS PROCEEDING is very similar to a corporate reorganization proceeding. The purpose is the same and with certain statutory differences the jurisdiction of the Court is the same. Details may differ but fundamentally the proceedings are the same. Due to the fact that there has been more corporate reorganizations than corporation proceedings under Section 75 a to r, we must of necessity seek for precedence established under Sections 77, 77B and similar laws.

In such proceedings objections have frequently been raised by creditors claiming vested rights. They have claimed that various acts of the Court deprived them

of their property without due "process of law", or that other constitutional provisions prevented the Courts from interfering with such vested rights.

THE QUESTION.

May the Court in a proceeding under Section 75 a to r of the National Bankruptcy Act reduce the interest rates on a secured claim from 6% to 4%. The creditor says no. The debtor and the Lower Court say yes.

If there ever was a case wherein the discretion and the equitable power of the Court should be exercised in favor of a debtor and its unsecured creditor this is such a case.

By the record in this case the debtor charges and the creditor admits the following:

a. That the security is worth $800,000.

b. The debt (at that time and it has since been reduced) was $180,000.

c. That the creditor, in bad faith, wants the $800,000 value of the security instead of wanting his claim paid.

d. That to bring about such an end (getting $800,000 instead of $180,000) he has maintained and intends to continue to maintain a series of unfounded, harassing and expensive series of objections, motions and proceedings.

e. That to reduce the interest rate will materially hasten the time when all claims will be

paid in full and the debtor financially rehabilitated.

f. That considering the nature of the security, the amount of the investment, and the present money market, it is just, equitable and right that the interest rate be so reduced.

g. That on such loan the creditor has received, in interest alone, $220,000 as well as $20,000 payment for a verbal promise to reduce the interest and extend the mortgage, (mortgage was due by its terms, October 1, 1924) but payments were kept up to October 1st, 1937 and $50,000 was paid on the principal. (See last paragraph of Creditor's claim pages 14-15 of record.)

h. That the security is not deteriorating or lessening in value but is being increased in value through the efforts of debtor to more quickly pay off its Creditor.

i. That the creditor released the makers of the notes and mortgages involved from all personal liability thereon and was required to and did release a second set of mortgages by the E. L. Dana Livestock Company (the same Company) and now claims benefit to himself in this proceeding because, he says, his claim is only against the property of the debtor.

In the light of the foregoing facts, appearing of record, Appellee wonders why the creditor is not also insisting that he be paid both principal and interest in gold coin of the United States of the standard of weight and fineness of September 29, 1919. (The note R. p. 15.)

Subdivision (k) of Section 75 (11 U. S. C. A. 203) provides insofar as material to this issue that:

> "Nothing herein shall prevent the reduction of the future rate of interest on all debts of the debtor, whether secured or unsecured."

But say counsel for Appellant, to give effect to such provision in this case would be contrary to the provision of the Constitution of the United States which provides:

> "No person—shall—be deprived—of property without due process of law."

The text of 12 C. J. 1195 in commenting generally on objections based on this amendment says:

> "So numerous, so varied, and in many cases so trifling have been the questions raised as to the protection afforded by the guaranty of due process of law, that objections founded on it have been judicially characterized as 'those last resorts of desperate cases' ".

Appellee believes that the following citations throw light upon the question involved. For example, in the case of *In Re Central Funding Corporation* (C. C. A. (2d) 1935) 75 Fed. (2d) 756, 27 A. B. R. (N. S.) 764, in a proceedings under 77B, a nonassenting secured creditor objected when the Court ordered that possession and title of real estate which it held under its contract and to which it claimed a vested right, be taken from the creditor in exchange for securities of a new corporation on substantially different terms.

The Court held that this did not violate the fifth amendment either with respect to due process or otherwise. In so holding the Court said, "It makes no difference whether the debtor has an equity or not, or whether his business is to continue for five or ten years or indefinitely".

In *Campbell v. Alleghany Corporation* (C. C. A. (2d) 1935) 75 F (2d) 947, 27 A. B. R. (N. S.) 504, the Court said in a very illuminating discussion of the Fifth Amendment and its application to the rights of a secured nonassenting creditor in a proceeding under 77B. (Par. 8, 9, and 10.)

> "Little need be said as to the question which arises under the Fifth Amendment—But *as any exercise* of the bankruptcy law impairs the obligation of contracts such an impairment is not to be taken as in itself a denial of due process. For the provisions of the Act to violate the Amendment, they must be so grossly arbitrary and unreasonable as to be 'incompatible with fundamental law.' " "Its purpose (speaking of such legislation as is here discussed) should be forwarded by a fair and liberal construction of its provisions, not thwarted by any narrow or technical conditions, and certainly not by reading into its language conditions and limitations which the law-makers themselves did not see fit to express."

It is suggested that the above rule also implies that the Court should not read out of the law the condition that Congress put therein or to add a condition to a condition as Appellant contends should be done.

In the case of *In Re Prima Company* (C. C. A. 7th 1937) 88F (2d) 785, 33 A. B. R. (N. S.) 554, the assets of the corporation were asserted to be worth about three million dollars and the liabilities about one million, the lower Court authorized the issuance of $20,000 of receiver certificates to be prior to the underlying mortgage. In discussing the matter in the Circuit Court the general authority of the Court under Section 77B was discussed and the conclusions reached are summarized in the syllabus as follows:

(Paragraph 2)

"Bankruptcy legislation being expressly authorized by the Constitution, is not subject to the same Constitutional limitations as other legislation effecting debtors' and creditors' contractural rights and obligations."

(Paragraph 3)

"All parties to contracts are subject to power of Congress to legislate on subject of bankruptcy and are chargeable with knowledge that their rights and remedies are effected by existing and future bankruptcy laws" etc.

(Paragraph 6)

"Section of Bankruptcy Act, permitting modification of terms of contract between corporations petitioning for reorganization under such act and holders of its bonds as to extensions of time, *rate of interest,* or substitutions of other securities with consent of over two-thirds of bondholders heed *not unauthorized, the modifying existing contracts and contractive rights and remedies of minority bondholders objecting* to reorganization plan." (Emphasis supplied.)

This Court in the case of *In Re Los Angeles Lumber Products Company,* 100 F. (2d) 963 (1939) held that the rights of minority bondholders could be materially impaired or changed even tho they claimed, and in fact had, a vested right in specific property probably worth more than the secured indebtedness.

In the Case of *In Re Grand Rapids Railroad Company,* 28 F. Supp. 802, it was argued and the Court held as follows:

> "It is urged that the unknown bondholders have vested rights in the securities and that to turn the unclaimed securities over to the reorganized debtor would result in the unjust enrichment of the known bondholders and destroy substantive rights in violation of the Fifth Amendment of the United States, U. S. C. A. * * * The fact that this provision effects vested rights does not render it unconstitutional. The power of Congress to enact bankruptcy laws necessarily implies the power to effect vested rights of many kinds."

The Court's authority in proceeding under 75, 77, 77B and similar laws all stem from the constitution of the United States and from the same provisions of it. If the Court must give up its jurisdiction to reduce interest in proceedings under Section 75, if the particular security is worth more than the particular claim, it follows that it must likewise give up that power under 77, 77B and similar laws. This it cannot do without decreeing that under no circumstance can Congress make such a law nor can the Courts enforce it because in this case we have such a number of ad-

mitted reasons requiring such adjustment that to the writer it seems almost impossible to have more persuasive reasons for the Court's application of the law.

Any bankruptcy law is an interference with vested rights. One vested right is no more secured or sacred than another unless perhaps to interfere with it would shock the conscience of the Court and is in opposition to some fundamental law. The writer believes that if the Court's conscience is to be shocked, it should be shocked by the conduct of Appellant who "craves the law", who relies on the letter of his bond, who brazenly admits that he is acting in bad faith, in utter disregard for the welfare of other creditors and the debtor, and who in effect pleads guilty to a misuse of legal proceedings and who does not deny that he intends to continue to endeavor to do so in his efforts to unjustly enrich himself.

The principle of law expressed in the statute governing the right to reduce interest rates is as old as written law. Lest it be thought that this is a "novel" law or an unconsidered novation born of some peculiar passing condition and therefore properly to be construed out of existence, let the Court consider a provision of the oldest code of written law yet discovered. Consider the *Code of Hammurabi,* Sec. 48, which reads as follows:

> "If a man owe a debt and Ahad (The Storm God) undate his field and carry away the produce, or through lack of water, grain has not grown in the field, in that year he shall not make any return of grain to the creditor, he shall alter his

contract tablet and he shall not pay the interest for that year."

This law was written about 2250 B. C. or over 4000 years ago. The forbidding of taking any interest under certain conditions was deemed by farmer and government of that time to be necessary, just, and proper. Undoubtedly common sense, the law of self-preservation, and national, even tribal interest, dictated such law long before that time. Today, the course of events should constrain all of us to face facts, not fine-spun theories of vested rights in future payments. For many years usury and interest were synonymous and forbidden. Today we forbid usury but allow a rate of interest limited by law. In reorganization proceedings and in Section 75 the right to take interest *after* the proceedings start is subject to be regulated in accordance with the enlightened conscience of the Court considering all the circumstances of the particular case. This certainly should not shock the conscience of any Court nor does it violate any fundamental law. We believe the Court has so held in the case of *Cohan v. Elder,* 112 Fed. (2d) 967, 43 A. B. R. (N. S.) 478. The facts and the objections are almost exactly alike in both cases. In that case like this debtor was under 75 a to r operating on a confirmed extension proposal. The creditor was the holder of a trust deed upon the real estate of debtor. Debtor got back on his interest payments (6%) and petitioned the Court for additional time and for reduction of interest from 6% to 3½% on future payments. After the petition but

before the hearing, the debtor paid one installment. The creditor resisted the petition on various constitutional grounds and argued that a 3½% rate was confiscatory. In the present case our creditor says it deprives him of property without due process of law.

In order to more closely examine the facts in case of *Cohan v. Elder* the writer borrowed from the attorneys in that case a copy of the printed transcript of record, including the evidence, pleadings and exhibits and while all facts do not appear of record in the decision of the circuit court they are available. From such in the *Cohan v. Elder* record the writer points out additional points of similarity as follows:

The Court retained jurisdiction during the extension period for supervision. (Memorandum of Conclusions of District Judge.)

> "Debtor had an equity in excess of $20,000 in the property that is subject to the trust deed of creditor. (See same.) That the total value of the assets exceeded the total indebtedness." (Same source.)

The obligation was one consisting of $15,000 of mortgages assumed by the debtor when he purchased the property from the creditor and $20,500 in the form of an obligation of debtor to creditor secured by a trust deed and an unsecured note for $10,000. (Brief of creditor in *Cohan v. Elder* case.) The interest rate was originally 7% on part of the obligation (Source: Brief of creditor) and 6% on balance. (Same source.) The creditor argues that he had a "vested right" in

the interest payments and that to disturb them was unconstitutional. (Creditor's brief.)

In the *Cohan* case, however, the attorneys for the creditor argued that the property was not worth the amount of the debt it secured. The court found that it was worth more. In the present case appellant saves us the trouble of proving that by arguing that such fact is a reason why the interest should not be reduced and that therefore the Court has no jurisdiction nor Congress the power to allow such act. In other words the Court for the reasons argued by Appellant against the granting of the reduction, granted it in the *Cohan* case.

Appellant seeks to distinguish his case by stating that there was no debtor in this case, that the claim is against the security only. The record shows that Mr. Bogart for a long time was in the position of having:

1st. The original notes and mortgages of E. L. and Fra Dana on the security.

2nd. The notes and mortgages of the Debtor for the same amount and security.

3rd. Was trying to hold the Danas on their endorsement of the Debtor's notes. (2nd set.)

The record discloses that it was necessary for Debtor to secure a court order to compel appellant to carry out his agreement to release the Danas, both from their liability as makers on the original notes and as endorsers on the second set of notes. Under the circumstances here involved there is no reason for making a distinction because there is no debtor personally

obligated. Although it is not in the record we must assume the Court below had good grounds for its actions. The matter is a claim against the property of the Debtor and as such is listed in the law the same as any other claim.

The purpose of the entire Act and proceeding is the rehabilitation of the debtor—the protection of the farmer and his other creditors secured and unsecured from ruthless creditors who, the better they are secured, the more strenuously, even angrily insist that they should have the "Letter of the bond" and by so doing in a time of national emergency destroy an efficient economic unit.

The Old Bankruptcy Act, interpretations of which are so freely cited by the creditor, was concerned primarily with *distribution* of the bankrupt's assets. The enlightened purpose of the Act governing this proceeding is, with proper safeguard to the creditor, to *rehabilitate* the farmer debtor. Consequently the question is: Will reducing the interest rate 2% invade any constitutional right of this creditor? This Court has answered: No, in an exactly similar case. The second question is: Will it aid in rehabilitation of the debtor? The allegations of the petition show it would.

DISCUSSION OF AUTHORITIES CITED BY APPELLANT.

Having discussed the debtor's position let us briefly examine the creditor's citations:

He first cites *Coder v. Arts,* 52 Fed. 943, a case decided in 1907 on a mortgage dated 1904. It was a straight bankruptcy proceeding. The land security had been sold and under the law as it then existed, the only question was that of distributing the proceeds. The Court ruled that as there was ample funds the mortgagor took his claim in full before the unsecured Creditor participated. There was no Section 75 in those days and the Court had no discretion on such matters nor was there involved any question of best interests of all concerned, nor had the policy of rehabilitation of the debtor without liquidation been yet adapted as a sound national policy.

Perhaps even then on equitable principles, had the creditor conducted himself like Shylock he might have been denied his "vested right" to future interest payments at least. The other cases cited by Appellant along this same line are subject to the same criticisms which we will not repeat.

Appellee-debtor does not deny and never has denied that accrued interest to date of adjudication is not involved. However, interest to accrue after the proceedings start is, in a proper case, subject to the letter of the law and the discretion of the Court.

In the case of *John Hancock, Mutual Life Insurance Company v. Bartels,* the question passed upon was not the question under discussion here. It was under subsection s of Section 75 and involved only the question of whether a farmer who was not able to demonstrate that there was a reasonable probability

of being able to rehabilitate himself within 3 years by paying his debts in full, could file under Section s. The Court held that he could so file and in general terms cited the main provision of the law, without, however, having before it or even mentioning the question of a reduction of interest in a proper case. For this reason, although it is a decision of the Supreme Court, it should not be regarded as authority on the points of law involved here and was not intended by such Court to be such authority.

The case of *Louisville Joint Stock Land Bank v. Radford* (1935) cited by Appellant is not now the law. It was an adjudication on the original Section 75s. No Court that we are aware of has ever held any part of 75 a to r unconstitutional. In any event the questions here are not the same as there decided. In fact the reasoning in that case has been generally abandoned by the Court itself in later decisions. Could it have been shown in that case as in this that a lessening of the interest rate would have hastened the desirable ends of creditors being paid in full, probably the Court would not have gone so far in condemning the original subsection s in such stern terms. At best that case has more historical than present legal value.

The Court did recognize in that case that a minority member of a class could have his vested rights altered so it might be cited as authority for the appellee because in the next case cited by Appellant (*Wright v. Mountain Trust Bank,* 300 U. S. 440) it is held by the Court that the benefit derived from the farmer's continued possession is beneficial to the secured creditor

in several ways, viz.: less expense, probably more efficient management of property than could be obtained through a receiver or trustee and that, "The farmer's proceedings in bankruptcy for rehabilitation resembles that of a corporation for reorganization". In any event it is discussing subsection s, not 75 a to r, or the provisions relating to a reduction in interest.

If the Appellant's contention that the right to receive future interest payments were followed to its logical conclusion it logically seems that the Court could not order a sale of property free of liens because to do so would stop interest payments that he would receive in the future and which he ardently wishes to obtain for as long a period as possible. A well secured creditor receiving a high rate of interest would have every incentive to prolong his take indefinitely.

In the *Wright* case the Court also said, "A Court of bankruptcy may effect the interests of lien holders in many ways". It listed a few of the ways which were already recognized. It did not pass upon any question regarding a Court order reducing future interest but certainly it listed things much more drastic as being completely within the Court's power.

Appellant labors to emphasize the difference between an extension and a composition. Certainly an extension proposal may be modified by the Court for cause shown by exercising the specific authority to reduce interest no matter whether the original proposal was for composition or extension, or a mixture of the two.

Nothing in the law provided that the debtor must ask, or the Court lower interest on all claims at the same time; nothing in the record brought up by the Appellant shows whether the interest rates on other claims have been changed or not, nor does the record show what the interest rates on other claims are. It does show that it might be well for the Court to retain some control over a creditor who attempts to misuse his favored position as this creditor has done in this case.

The debtor is willing that the creditor get his just dues as soon as it is possible within the law and with due regard to the other creditors, particularly the large number of unsecured creditors. However, under the circumstances of this case, the creditor does not stand in Court with clean hands and certainly is not entitled to invoke the equitable discretion of the Court. He stands in this Court, self-confessed and unabashed, demanding his pound of flesh regardless of all other considerations or evil results to all others involved. He has been touched in his only tender spot, his pocket book, by the only thing that apparently hurts him, a reduction from 6% to 4% of the interest accruing and to accrue during this proceeding.

The debtor believes that the law should stand as written and that the discretion of the trial Judge was wisely used in following *Cohan v. Elder,* supra, and reducing the interest rate on this claim from 6% to 4%.

This creditor appears to the debtor as one who believes that individual economic anarchy is guaranteed

to him by the Constitution. At best he says he has not had "due process of law", as to future interest payments. He does not argue that the reduced interest is not fair or adequate. On the record he admits that it is reasonable. He simply argues that this Court should read into the law an exception which Congress did not see fit to pass. He admits that he and the other creditors will get their claims paid in full sooner than they would if the interest was not reduced. Surely this should compensate for, and balance this slight and temporary inconvenience he experiences now.

As to his argument that in the *Cohan v. Elder* case the interest rate was reduced only as to the time of the proceedings it is without weight for the entire debt is scheduled to be paid in full during the proceedings and his right to receive any interest from this debtor shall stop when he is paid his principal plus interest at 6% to the start of the proceedings plus 4% on that balance, and on the unpaid balances to the date of the final payment. He has already received much. He has done much wrong that he does not deny. He should not receive more from the hands of any Court.

Dated, Parkman, Wyoming,
December 22, 1941.

Respectfully submitted,
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